No. 12,828

IN THE

United States Court of Appeals

For the Ninth Circuit

ALICE McCOURT LAMM,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S OPENING BRIEF.

HARRY R. HORROW,
FRANCIS N. MARSHALL,
CLAUDE H. HOGAN, JR.,
THOMAS E. HAVEN,
225 Bush Street, San Francisco 4, California,
Attorneys for Petitioner.

Table of Contents

Table of Authorities Cited

Cases

Statutes

Miscellaneous

No. 12,828

IN THE

United States Court of Appeals

For the Ninth Circuit

ALICE McCOURT LAMM,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S OPENING BRIEF.

STATEMENT AS TO JURISDICTION.

Petitioner filed her income and victory tax return for the calendar year 1943 with the Collector of Internal Revenue for the District of Oregon (R. 20). On November 26, 1948, respondent mailed to petitioner a notice of deficiency in income and victory taxes for the year 1943 in the amount of $4,246.73 (R. 21-22). Petitioner filed with the Tax Court a petition for a redetermination, asserting that there was no deficiency (R. 5-10). On September 26, 1950, the Tax Court rendered its decision sustaining the Commissioner's determination of deficiency, and entered decision accordingly (R. 131, 146). The petition for review in this court was filed December 26, 1950 (R. 147, 152).

This court has jurisdiction under the provisions of sections 1141 and 1142 of the Internal Revenue Code.

THE STATUTE INVOLVED.

The statute involved is section 117(f) of the Internal Revenue Code, which defines capital gains and losses in part as follows:

> "Sec. 117. Capital Gains and Losses.
>
> * * *
>
> (f) Retirement of Bonds, Etc.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

STATEMENT OF THE CASE.

The question in this case[1] is whether corporate notes, which were retired with resultant gain to the owners, were "in registered form" within the meaning of section 117(f) of the Internal Revenue Code, so as to permit the owners to treat their gain as a capital gain for income tax purposes rather than as ordinary income as the Commissioner determined. The Tax Court held that the statute requires corporate notes, in order to come within its terms,

---

[1]The case is one of fifteen cases, identical in substance and all arising out of the same transaction, which are here together on review of the Tax Court decisions therein. By order of this court (R. 154-156), abbreviated records have been filed in the other cases, to which reference may be made in the briefs and arguments; and upon entry of the judgment of this court in this case, this court will order similar judgments entered in the other cases.

In this brief, where necessary to a complete picture of the facts, we shall refer to the taxpayers and petitioners in all the cases collectively.

to be put into registered form *by the debtor corporation,* and that the debtor corporation did not do so here. The taxpayers, on this review of the Tax Court's ruling, contend that the Tax Court erred both in its construction of the law and in its interpretation of the facts; in other words, that the only requirement of the law is that the ownership of the notes be registered, regardless of who may take the action registering them; but that even if the law did require action by the debtor corporation, the latter sufficiently participated in the registering transaction in this case.

The issue is further narrowed by reference to what is already settled. (These matters will, of course, be properly considered in the body of this brief, but an understanding of what is, and what is not, in controversy will be helpful in the reading of the facts.) First, corporate notes, to come within the statute, need not be originally issued in registered form; it is enough that they are registered at the time of their retirement (*Lurie v. Commissioner of Internal Revenue* (9 Cir. 1946) 156 F.2d 436). Second, "in registered form" is meaningless except as it relates to an instrument which *is registered*—i.e., its ownership entered in a register; in other words, the phrase refers to the condition of the instrument rather than to any particular words in the body of it. The register need not be maintained by the debtor corporation. In accordance with these principles, and with the basic purpose of the statute, it is the taxpayers' contention that what was done here fully satisfied the language and the purpose of the statute, both as self-evident and as disclosed by the *Lurie* and other cases.

The facts as stated below are stipulated (R. 19 et seq):

On May 6, 1930, and on September 5, 1930, respectively, Lamm Lumber Company, a corporation, issued two promissory notes in the respective principal sums of $150,000 and $250,000, payable to the order of Consolidated Securities Company, hereinafter referred to as "Consolidated," in consideration of loans from the latter in those two sums (R. 23). Each of the notes (R. 29, 31) was secured by a mortgage on a certain railroad owned by Lamm Lumber Company, and as part of the same transactions, Lamm Lumber Company gave options to Consolidated to purchase the railroad in preference to any other purchaser on the same terms (R. 23-24). On May 26th and September 30, 1930, Consolidated executed respective declarations of trust that it held the notes, mortgages and options for the benefit of Southern Pacific Land Company, and at all times prior to July 1, 1941, Southern Pacific Land Company was the beneficial owner of the notes, mortgages and options (R. 24).

From March 5, 1932, to September 5, 1934, various additional notes (R. 33-47) were issued by Lamm Lumber Company to Consolidated representing unpaid interest on the corporate indebtedness (R. 24). On December 24, 1936, Lamm Lumber Company and Consolidated entered into a supplementary agreement (R. 48-55) reciting the indebtedness and mortgages, compromising the unpaid interest as to its amount, funding the interest and accruals to January 1, 1938, by adding them to the principal, restating the new principal at January 1, 1938, as $497,845, and stating interest from January 1, 1938, to be 3 per cent (R. 24). Lamm Lumber Company, the obligor, covenanted

to pay monthly $5 for each car of logs shipped over the railroad with minimum payments of $15,000 a year until December 31, 1941, and $35,000 a year thereafter, the payments to be first applied on interest and then on principal (R. 24).

On February 8, 1940, Consolidated endorsed to The Anglo California National Bank of San Francisco all of the promissory notes, without recourse, and assigned to that bank its rights as mortgagee (R. 24-25).

At various times from February 10, 1938, to June 11, 1941, Lamm Lumber Company made payments on the debt in accordance with the agreement of December 24, 1936, so that as of June 12, 1941, the sum owing by Lamm Lumber Company to Southern Pacific Land Company was $411,-264.99. All of the notes were then on their face past due (R. 25).

For some time prior to July 1, 1941, Southern Pacific Land Company had been desirous of liquidating its lumber interests in Northern California and Oregon and let it be known that it would be willing to sell its interest in the Lamm Lumber Company notes at a substantial discount. In order to avail themselves of the investment opportunity thus presented, certain individuals, including petitioners herein (petitioners' decedents in the cases of the four estates) each on his or her own behalf, offered to purchase at the proffered discount undivided fractional interests in the notes, making in total 100 per cent of the ownership of the notes. These offers were presented to Southern Pacific Company (parent company of Southern Pacific Land Company) on behalf of Southern Pacific Land Company as an

offer to purchase the total ownership of the notes for a sum amounting to 50 per cent of the balance of the principal of the loan plus the interest currently due at the time of the completion of the purchase. This offer was subsequently accepted by Southern Pacific Company on behalf of Southern Pacific Land Company, and on July 1, 1941, these individuals paid over to Southern Pacific Land Company the various amounts agreed to be paid by them for the purchase of the undivided fractional interests and totaling the sum of $206,388.55, and the beneficial ownership of the notes and mortgages was transferred from Southern Pacific Land Company to the individuals in proportion to their undivided fractional interests (R. 25-26).

The individuals, as beneficial owners of the undivided fractional interests in the notes by virtue of the purchase related above, entered into a written agreement called "Instructions and Agreement" (R. 55-62), dated July 15, 1941, with American Trust Company, hereinafter referred to as "Trust Company" (R. 26). In executing the agreement each of the individuals signed an individual counterpart, stating therein his or her percentage interest in the notes. Contemporaneously with the delivery of the Instructions and Agreement to Trust Company, the individuals delivered to Trust Company a list (R. 63-64) of the names, addresses, amounts invested, and their percentage interests (R. 26).

Pursuant to the Instructions and Agreement, the notes were endorsed, and the mortgages assigned, to Trust Company to hold and keep in its possession in accordance with the instructions contained in the Instructions and Agreement (R. 26-27).

In accordance with the Instructions and Agreement, Trust Company duly remitted collections of interest and principal paid to it by Lamm Lumber Company to those owners shown to be entitled thereto in accordance with the ownership interests set forth in the list. During this period, none of the individuals sold or exchanged his undivided fractional interest in the notes. In several instances, however, certain owners changed their addresses, informing Trust Company of the change, and Trust Company thereupon mailed its remittances to the new addresses (R. 27).

Trust Company's charges for its services in collecting and remitting interest and principal payments and in maintaining a record of ownership were shared by the participating owners of record and by Lamm Lumber Company in the following manner: As agreed in the Instructions and Agreement, Trust Company charged the sum of $500 as an acceptance fee, an annual fee of $100 plus 1/10 of 1 per cent of the unpaid balance of the obligation at the beginning of each year, and $250 as a closing fee, plus reimbursement for out-of-pocket expenses. Of these charges Lamm Lumber Company agreed by letter (R. 64-65) dated August 26, 1941, to Trust Company to pay sums at the rate of $250 per annum which were credited against the foregoing total charges (R. 27). In the same letter the Lamm Lumber Company instructed the Trust Company to compute and pay interest on the basis of 365 days per year instead of following the customary banking practice of using 360 days (R. 64-65).

On December 7, 1943, the notes were retired by payment of the balance of the principal and interest due thereon.

During the year 1943 petitioners realized gains on the retirement of the notes in amounts proportionate to their fractional ownership thereof (R. 27).

The gains realized by petitioners were reported in their income and victory tax returns for the calendar year 1943 as long-term capital gains, of which 50 per cent were reported as income (R. 27).

The Commissioner determined deficiencies against each of the petitioners, upon the basis that the gains were taxable as ordinary income, i.e., in their full amount (R. 133). The petitioners duly petitioned for a redetermination of the deficiencies (R. 22), and the Tax Court consolidated the various cases for trial and opinion (R. 67). The facts were for the most part stipulated, but additional testimony was received. The Tax Court entered findings and an opinion (R. 131)[2] sustaining the Commissioner's determinations of deficiency, and entered decisions accordingly (R. 146). The cases are here on the taxpayers' petitions for review.

The oral evidence consisted of the testimony of the trust officer of the Trust Company. In particular, his testimony brought out that the Trust Company looked to the list of ownerships as establishing the owners from time to time of the notes, and the proportions of their ownership, so as to determine to whom and in what amounts all payments of interest and principal should go. After showing, chiefly in response to questions by the Court, that a transfer of ownership would be recognized only upon receipt of documentary evidence consisting of an assignment properly

[2]Reported, 15 T.C. 305.

witnessed or acknowledged, followed by a change of the Trust Company's card record and a corresponding change of the list of ownerships, the trust officer testified (R. 126):

> "The Court: In other words, it was your duty, was it, to make payments only to people whose names appeared on this list of July 1, 1941, which is in evidence in this case as Exhibit 3-C?
>
> The Witness: That is right."

The foregoing statement sets out the basic facts and points of controversy between the parties. More detailed reference to particular facts will appear where pertinent in the course of the argument.

SPECIFICATION OF ERRORS RELIED UPON.

Petitioner relies upon the following errors:

The Tax Court erred:

1. In failing to hold that the notes of Lamm Lumber Company were "in registered form" at the time of their retirement within the meaning of section 117(f) of the Internal Revenue Code.

2. In holding that said notes were not "in registered form" within the meaning of said section unless they were issued or reissued in registered form by Lamm Lumber Company.

3. In holding that the ownership of the notes of Lamm Lumber Company was not evidenced by a register within the provisions of section 117(f) of the Internal Revenue Code.

4. In holding that the agreement of July 15, 1941, with the American Trust Company did not result in the registration of said notes within the provision of section 117(f) of the Internal Revenue Code.

5. In holding that the Lamm Lumber Company was not a party to said agreement.

6. In holding that American Trust Company was not an agent of Lamm Lumber Company.

7. In holding that the taxpayers realized ordinary income on the retirement of the notes of Lamm Lumber Company, and in failing to hold that the taxpayer realized a capital gain on the retirement of said notes.

8. In determining that there was a deficiency in income and victory tax for the taxpayer for the calendar year 1943 in the amount of $4,246.73, and in failing to hold that there was no deficiency in said taxes for said year.

SUMMARY OF ARGUMENT.

Basic principles already settled point the solution of this case. The decision of this court in *Lurie v. Commissioner of Internal Revenue* (9 Cir. 1946) 156 F.2d 436, makes it clear that the law concerns itself only whether the securities are registered at the time of their retirement, without regard to how or when or by whom they become registered.

The only requirement of the law is that the securities *be registered,*—i.e., having their ownership entered in a register or list which governs payment of principal and

interest. The law does not distinguish between *kinds* of registers. The register which was kept here, and which determined to whom payments were made, met every requirement of the statute. The Trust Company treated it as a register of owners and of ownership interests, to be kept by it as such.

It is stipulated that the taxpayers purchased the notes for investment. They realized a gain through increase of the debtor corporation's ability to pay,—an appreciation of the value of their capital investment. This is the essence of a capital gain and met the basic purpose of the statute in differentiating securities for long-term investment from those representing ordinary commercial transactions. The Tax Court further erred in holding that the statute requires the securities to be put into registered form by the debtor corporation; but even if there were such a requirement, the debtor corporation sufficiently participated in this case.

ARGUMENT.

PRELIMINARY UNDERLYING PRINCIPLES:

(1) IT IS NOT NECESSARY THAT THE INSTRUMENTS BE ISSUED IN REGISTERED FORM.

(2) "IN REGISTERED FORM" SIMPLY MEANS ENTERED IN A REGISTER, SO AS NOT TO BE TRANSFERABLE OR PAYABLE EXCEPT THROUGH THE REGISTER.

(3) IT IS NOT NECESSARY FOR THE DEBTOR CORPORATION TO MAINTAIN THE REGISTER.

(4) THE PURPOSE OF "WITH INTEREST COUPONS OR IN REGISTERED FORM" IS TO DIFFERENTIATE FOR CAPITAL GAINS TAX TREATMENT THE LONG-TERM INVESTOR FROM THE ORDINARY CREDITOR OR SHORT-TERM SPECULATOR.

Preliminarily, there are certain settled principles which underlie the precise issue.

First: It is not necessary that instruments be *issued* in registered form. They can be put into registered form later and still be entitled to the benefits of section 117(f), if a gain is realized upon retirement. This court definitely so decided in *Lurie v. Commissioner of Internal Revenue* (9 Cir. 1946) 156 F.2d 436, saying (p. 437):

> "Respondent contends that, because the notes were not issued in registered form, they did not come within subsection (f). The Tax Court did not so hold, nor is there any basis for such a holding. To come within subsection (f), a note must be issued by a corporation and, unless it is a coupon note, must be in registered form at the time of its retirement, but it need not be in registered form at the time of its issuance."

Second: "In registered form" is meaningless except as it means an instrument which *is* registered. It may perhaps include, but is not to be confused with, the idea of

"registrable form"—i.e., one which *may become* registered. The *Lurie* case shows that an instrument which is in fact registered at the time of its retirement is what is embraced within the section. The usual corporate bond, for example, may be issued to bearer and later registered at the bearer's request (R. 117-118), although other bonds in the series are not registered (*Benwell v. Mayor, etc., of City of Newark* (1897) 55 N.J.Eq. 260, 36 Atl. 668, 670; Hoagland, Corporation Finance, 3d Ed., 1947, p. 184).

Third: It is not necessary for the debtor corporation to maintain the register. Usually a bank or trust company acts as registrar (Munn, Encyclopedia of Banking and Finance, 5th Ed., 1949, p. 585; Bonneville and Dewey, Organizing and Financing Business, 3d Rev. Ed., 1946, p. 137)—as in this case.

Fourth: The recognized purpose of the qualifying phrases "with interest coupons or in registered form" is to differentiate corporate securities which are held for true investment purposes from those which are held simply as evidence of a debtor-creditor relationship or for short-term speculation or trading. Taxation of long-term investments accords them the benefit of capital gains tax treatment. Corporate obligations which are registered or bear interest coupons are the kinds which taxpayers usually acquire and hold for investment purposes. The court recognized this purpose in *McClain v. Commissioner of Internal Revenue* (5 Cir. 1940) 110 F.2d 878, affirmed (1941) 311 U.S. 527, where the court said (110 F.2d 878):

> "The corporate paper described as registered or bearing coupons is intended for long time investment. The effect of the provision is to make the retirement of

> it by the maker equivalent for tax purposes to a sale of it to another, and the necessary consequence is that it falls under the capital assets provisions of Sec. 117(a) and (d), and if it has been held more than a year a loss cannot be taken into account at 100 per cent, and the limitation of capital net losses to $2,000 will apply.''

It is noteworthy that this capital gains tax treatment works both ways; i.e., the long-term capital investor is taxed upon only 50 per cent of his capital gain, but also gets credit for only 50 per cent of his capital loss (subject to further limitation as to the total allowable capital losses —sec. 117(d)(2)). This is in contrast to corporate notes held merely as evidence of a debtor-creditor relationship, which, when retired, give rise to a gain or loss taxed or credited at 100 per cent under the ordinary income tax provisions.

When the loss aspect of section 117(f) is considered, it is apparent that Congress meant to include within the meaning of the section notes such as are involved here. Section 117(f) was enacted in 1934, a time when defaults on corporate obligations were much more common than today. Until the enactment of this section, taxpayers were allowed to deduct the entire loss resulting when a corporation redeemed its obligation for less than the amount paid for it. In substance, as the court said in the *McClain* case, there is no difference as far as the taxpayer is concerned whether he sells the security or redeems it with the issuing corporation, and it was the intent of Congress that the two transactions receive the same treatment taxwise. See *S. C. Thomson* (1939) 40 B.T.A. 60, 62-63, rev. (2 Cir.

1940) 108 F.2d 642, which was reversed sub nom. *McClain v. Commissioner* (1941) 311 U.S. 527; *Rieger v. Commissioner of Internal Revenue* (6 Cir. 1943) 139 F.2d 618, 621.

These basic principles show that it is the condition or status in which the notes are held—not the form in which they are issued—that determines whether they are "in registered form" within the meaning and purpose of section 117(f). This status is important only from the holder's standpoint—which is logical, since it is the gain or loss to the holder that is in question. It is the holder who benefits from registration in guarding against loss or theft of the instrument—which is the entire object of registration. It is the holder who bears the attendant disadvantage of registration, i.e., the impairment of negotiability. The fact that the notes are registered, and not who initiates or accomplishes registration, is what is important.

FIRST: THE ESSENTIAL CHARACTERISTIC OF REGISTRATION IS THE MAINTENANCE OF A REGISTER OF THE OWNERSHIPS OF SECURITIES, WHICH DETERMINES TO WHOM PAYMENTS SHALL BE MADE AND UPON WHICH ANY CHANGE OF OWNERSHIP IS NOTED.

As shown above, "in registered form" means entered in a register. This type of registration is, after all, merely a system of handling, developed for the purpose of protecting the security owner against the consequences of loss or theft of the security. It also serves the purpose of permitting the security owner to receive payments upon the security (e.g., of interest) without having to present the security. To effect these purposes a "reg-

ister," or list, of the owners of the securities—those who desire the advantages of registration—is maintained, with provision that the debtor corporation shall make payments to those owners whose names are shown upon the list.

Negotiability is thus impaired to a certain extent; i.e., the transferee of a registered security must show to the keeper of the register satisfactory evidence of the transfer and must have the register changed so as to show him as the current owner of the registered security. See:

6A Fletcher, Corporations (1950), p. 13;
Montgomery, Financial Handbook (1925), pp. 575, 1136.

As the Tax Court said in *Matilda S. Puelicher* (1946) 6 T.C. 300, 303:

> "The phrase 'in registered form' implies, at least, that the owner of the instrument is listed in a register maintained for that purpose and that its negotiability is impaired to the extent of the necessity for changing the registration to indicate the change of ownership."

SECOND: WHAT WAS DONE IN THIS CASE MET ALL THE ESSENTIAL REQUIREMENTS OF REGISTRATION. THE NOTES WERE, THEREFORE, "IN REGISTERED FORM" AT THE TIME OF THEIR RETIREMENT, AND THE GAIN REALIZED THEREFROM BY THE TAXPAYERS WAS A CAPITAL GAIN.

The taxpayers were not the business creditors of the debtor corporation, nor were they short-term speculators; they were investors in the notes as a form of corporate security on which they hoped to realize a gain, by buying and holding till retired. They made a capital

investment, and they realized a hoped-for gain through the appreciation of that capital investment. This is the very essence of a capital gain as contemplated by the tax structure.

These facts are stipulated. Paragraph VI of the stipulation of facts stated (R. 25):

> "*In order to avail themselves of the investment opportunity thus presented* [i.e., by the previous note owner's willingness to sell the notes at a substantial discount], certain individuals, including petitioners herein * * * offered to purchase at the proffered discount undivided fractional interests in said notes, * * *. Such offer was subsequently accepted * * *."

When the notes were delivered to the Trust Company,

> "said individuals delivered to the Trust Company a list of the names, addresses, *amounts invested,* and percentage interests of said individuals" (Stipulation of Facts, par. 7; R. 26)

—the very list which the Trust Company thereafter maintained as its master list of the note owners, and thereafter "duly remitted collections of interest and principal paid to it by Lamm Lumber Company to those owners shown to be entitled thereto in accordance with the ownership interests set forth in said Exhibit 3-C" (Stipulation of Facts, par. 8; R. 27).

The statutory requirement that a register be set up was fully met. The taxpayers handed over to the Trust Company the corporate notes with instructions and a list of the ownerships of the various interests in the notes. The Trust Company checked the list to make sure that it was in correct form to control the making of payments

on the notes,[3] and thereafter remitted interest and principal as received "to those owners shown to be entitled thereto in accordance with the ownership interests set forth" in the list (R. 27).

In the ordinary case of a registered bond, change of ownership would entail bringing in the bond to the registrar, with documentary evidence of the transfer of ownership (usually in the form of the registered owner's signature to an assignment form), and requesting a change of the register to show the new ownership. Here the first step was obviated by the act of turning the notes physically over to the Trust Company to hold. The second step—documentary evidence of transfer—was contemplated in the instructions and agreement exactly as in the ordinary case; the instructions provided (R. 61):

> "You shall not be bound to take notice of any change in the ownerships of the interests of any of the undersigned unless and until there shall have been filed with you such documentary evidence as you shall consider necessary to establish such change."

The third element—the register—was kept by the Trust Company just as in the case of an ordinary registered security. The Trust Company took the list of ownerships and from it made up a set of cards, one for each owner, showing the amount of his interest, etc. Payments on the notes were thereafter made according to the card record, checked back against the list (R. 91, 95-96).

---

[3]It was not. After correspondence with one of the purchasers of the notes, the trust officer of the Trust Company corrected the list by changing the designation of such purchaser from "Natural Guardian" to "Trustee" for Winifred Carol Lamm (R. 86-89).

In the ordinary case of a registered bond, the same procedure in substance would occur. To illustrate this procedure, petitioners introduced in evidence a sample form of corporate bond (Pet. Exh. 8; R. 119), which provided in the usual language (R. 119) as regards transfer (R. 117-118):

> "* * * this bond may from time to time be registered as to principal in the holder's name * * *
>
> * * * * *
>
> 'After such registration no further transfer of this bond shall be valid unless made on said books by the registered owner in person or by an attorney duly authorized and similarly noted hereon, but this bond may be discharged from registry by being in like manner transferred to bearer.' "

The trust officer of the Trust Company testified (R. 118-119):

> "To what has 'registration on said books'—to what does that refer?
>
> A. Well, the only registration books that we ultimately keep are the cards. Those are the lists from time to time—or those are the cards from which the lists of registered owners are made and those cards are kept by us on behalf of the various corporations we represent of the various issues."

The lack of any requirement that any notation of registration appear on the instruments themselves is clear from the testimony of the trust officer of the Trust Company in answer to questions of counsel and of the court. To effect a transfer, he testified that an assignment in general form transferring the ownership, properly witnessed or acknowledged, would have been acceptable (R. 120). The court pursued this line of inquiry (R. 123-126):

"The Court: Just one other question: If Edith Lamm sold W. E. Elliott her interest in the notes, what would happen as far as you were concerned under your duties?

The Witness: I will have to make the assumption of what we do because there were no changes of ownership, but——

The Court: There were no changes. That is an important fact. But I would ask you to describe what you would have done if there had been any changes in ownership and explain, give your reasons to show fully why you would have to do what you say you would do, because there are always practical if not legal reasons for doing things in a certain way.

The Witness: The first evidence of it, I assume, would be some attempt at a transmittal to us of the assignment form showing that Edith Lamm had transferred her interest as evidenced by this list and by the document which she signed over to W. E. Elliott.

The Court: Now, may I ask you another question there: If some evidence were not presented to you, you would continue to make interest payments to Edith Lamm, wouldn't you?

The Witness: Yes, and also capital.

The Court: Capital payments?

The Witness: Yes.

The Court: So that if W. E. Elliott wanted to receive payments from you he would have to send something or a letter to you, wouldn't he?

The Witness: Together with some kind of documentary evidence showing the transfer from the seller to him of the interest that he was buying.

The Court: All right, now. What would you have required of him to be on the safe side? The Court knows the Trustee was acting as judiciary [in a fidu-

ciary] capacity, have to be very careful. If anything goes wrong, they are liable for it, and the Trust Departments have counsel to advise them on all these things. Now, out of your experience, what would you have required as manager of the Trust Department?

A. A document undertaking to assign the interest of the transferor to the transferee, which would have to satisfy ourselves, *would be in sufficient form* signed and preferably acknowledged or witnessed by someone whose signature would be acceptable to us.

* * * * *

The Witness: Then that document would have been put in our vault because it would be an important document. * * *

* * * * *

The Witness: * * * Then a memorandum would have originated from me to Mr. King who was in charge of the bookkeeping department, indicating that by assignment bearing its date Mrs. Edith Lamm had transferred her interest in the Lamm Lumber Company indebtedness over to W. E. Elliott, indicating his address and that all future payments which heretofore would have been made to Mrs. Edith Lamm, by reason of her ownership, should hereafter be made to Mr. Elliott by reason of his ownership.

The Court: What would Mr. King do?

The Witness: Mr. King would take—let me make one more comment. I would have to indicate the change likewise, not only on the signed counterpart of the letter of instructions and agreement, but also on this list so that the operating legal file would at all times be correct.

The Court: Be something, in other words, to strike out Mrs. Edith Lamm's name entirely and substitute

W. E. Elliott's share to—increasing his percentage interest also, is that right?

The Witness: That is right, and then Mr. King would have made the same change upon the copy that he kept in the Bookkeeping Department and would have had the girl who was the typist in charge of the physical work of making up those disbursements change her card also, showing that Mrs. Lamm was no longer an owner and Mr. Elliott's share had changed from 12 and a fraction per cent to 24 and a fraction per cent.

* * * * *

The Court: *In other words, it was your duty, was it, to make payments only to people whose names appeared on this list of July 1, 1941, which is in evidence in this case as Exhibit 3-C?*

The Witness: *That is right.* The copy that Mr. King kept in his department throughout the administration of the account was kept for that purpose" (emphasis added).

It is of the greatest significance that the Trust Company itself considered and treated the list of ownerships as a register, which in itself absolutely controlled the payment of interest and principal on the notes. The testimony just quoted makes this fact clear beyond dispute. Moreover, when counsel for the Commissioner asked the direct question of the trust officer of the Trust Company (R. 102-103):

"Q. (By Mr. Mather):* * *

Do you know whether these promissory notes were in registered form?

* * * * *

A. * * * They were not coupon instruments but they were registered, every one of them was registered to a particular payee."

The foregoing demonstrates, we submit, that the Tax Court erred in deciding (R. 144-145):

"The records which the American Trust Company which [sic] were kept for the purposes of acting as a collecting and disbursing agent are not the *kind* of register which satisfies the requirements of section 117(f)" (emphasis added).

The statute does not differentiate between *kinds* of registers. All it requires is that the security be registered at the time of retirement. No particular formality is specified or intimated. Actually the authorities establish that all kinds of registration, of the most informal types, are embraced within the statute.[4]

In a further aspect the Tax Court erred in its understanding of the status of the Trust Company. By no means was the arrangement the mere establishment of an agency for collection of amounts due the various purchasers of the notes, revocable at the will of any one of

---

[4] *Rieger v. Commissioner of Internal Revenue* (6 Cir. 1943) 139 F. 2d 618 (claim certificates issued by state superintendent of banks showing right to deposits with insolvent bank);
Edith K. Timken (1946) 6 T.C. 483 (notes of reorganized bank given in exchange for claim certificates);
Estate of Clara E. Martin (1946) 7 T.C. 1081 (certificate issued by building and loan association with passbook attached providing for variation in amounts on deposit);
Commissioner of Internal Revenue v. Caulkins (6 Cir. 1944) 144 F.2d 482 (certificates of Investors Syndicate);
Howard Carleton Avery (1949) 13 T.C. 351 (certificates of a cemetery association).

them who might change his mind. The instructions and agreement expressly provided (R. 61):

> "These instructions may be terminated at any time by the then holders of 100% of the interest in said obligation, but not otherwise."

In other words, the consent of every one of the holders of the notes was required in order to revoke the arrangement —a binding condition far more consonant with registration than with a mere agency for collection.

THIRD: THE TAX COURT ERRED IN HOLDING THAT EVIDENCE OF INDEBTEDNESS, TO COME WITHIN SECTION 117(f), MUST BE PUT INTO REGISTERED FORM BY THE DEBTOR CORPORATION.

The Tax Court erred fundamentally in holding that a registered corporate security, to come within section 117(f), must be put into registered form *by the debtor corporation.* The debtor corporation has no interest in the question. The interest is that of the holder, who if he is a true investor and intends to hold the security as an investment may well wish the safeguards and convenience of registration. If a group of holders wish to establish a register for the safe and effective handling of their holdings, there is nothing in the statute to exclude such action—*unless* the words "in registered form" are tied to and are a qualification of the words "issued by any corporation," rather than to the list of instruments themselves—bonds, debentures, stocks, etc. But this court has already shown (*Lurie v. Commissioner of Internal Revenue,* supra (9 Cir. 1946) 156 F.2d 436) that the

words in question do *not* qualify or limit the word "issued," since this court expressly held in that case that securities, to come within the statute, need not be *issued* in registered form. This holding gives logic and grammatical consistency to the statute, recognizing that the entire phrase "with interest coupons or in registered form," set off by commas from the words preceding, relates to the list of securities—"bonds, debentures, notes," etc. Had it been intended that the phrase should be a limitation upon the words "issued by any corporation," it would not have been set off from the words it was supposed to qualify or limit.

The statute, thus construed by this court in the *Lurie* case, pays no heed to how, or when, or by whom, the securities became registered. Its concern is solely: Were the securities registered at the time of their retirement?

The error of the Tax Court is not only one of grammar, but it is also one of substance. It seeks to stress the act of the debtor corporation as the important factor. But, as we have seen, it is the security holder's standpoint that is important.

Also as we have seen, it is possible for a registered security to be transformed into a bearer instrument by assignment in blank, and then to be reconverted into a registered security by any subsequent holder through the simple expedient of requesting the registrar to register it. This can take place without any intervening act of the debtor corporation; it can be a transaction simply between the holder and the registrar. The same is true of a bond originally issued as a bearer bond, which can

be subsequently registered by the bearer through the registrar without any further action on the part of the debtor corporation.

FOURTH: EVEN IF THE STATUTE REQUIRED THAT THE INSTRUMENTS BE PUT INTO REGISTERED FORM BY THE DEBTOR CORPORATION, HERE THE CORPORATION SUFFICIENTLY PARTICIPATED TO SATISFY THE REQUIREMENT.

If it were necessary under the statute that the instruments be put into registered form by the debtor corporation (which we have seen is *not* required by either the grammar of the section or by the theory of it), in this case the Lamm Lumber Company sufficiently participated to satisfy the requirements. There is no question that the entire transaction was accomplished with full knowledge and approbation of the Lamm Lumber Company, for it wrote a letter to the Trust Company (Exh. 4-D; R. 64-65) in which it made plain reference to the new ownership of the obligation and agreed to pay the Trust Company a part of the cost of its services, stating that the participants in ownership should pay the balance. In this letter, also, the Lamm Lumber Company instructed the Trust Company to compute interest on the basis of 365 days per year in lieu of the customary banking practice of computing interest on 360 days per year—a fact important as showing that the Trust Company was acting, to some extent at least, as agent of the lumber company as well as (for some purposes) agent of the security owners. There was no reason, of course, why the Trust Company could not or should not act as agent, for correlative purposes, of both the debtor corporation and the purchasers of the notes; and the payment arrangements

and the directions given by the lumber company to the Trust Company show plainly that it was doing so.

The question is concluded by the stipulated fact that "Trust Company's charges for its services in collecting and remitting interest and principal payments *and in maintaining a record of ownership were shared* by the participating owners of record and *by Lamm Lumber Company* * * *" (emphasis added) (Stipulation of Facts, par. 9; R. 27).

The debtor corporation was not, therefore, merely playing the part of acquiescence; in what the Trust Company did, it served the debtor corporation and acted on its behalf.

CONCLUSION.

For each of the foregoing reasons, we respectfully submit that the judgment of the Tax Court was erroneous and should be reversed.

Dated: San Francisco, California,
April 17, 1951.

Respectfully submitted,
HARRY R. HORROW,
FRANCIS N. MARSHALL,
CLAUDE H. HOGAN, JR.,
THOMAS E. HAVEN,
Attorneys for Petitioner.